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C.E.O. Opinions of the DIDMC Act of 1980

by

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Introduction

The Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA) was passed by the 96th Congress of the United States and signed into law by former President Carter on March 31, 1980. This legislation represents a major reform of our financial system. Many observers view DIDMCA as being the most far-reaching banking legislation passed since the 1930's.

The key provisions of DIDMCA were: (1) NOW accounts were authorized nationwide for all depository institutions; (2) Deposit reserve requirements were restructured, simplified and applied to all depository institutions; (3) Thrift institutions were granted expanded lending authority; (4) The Depository Institutions Deregulation Committee (DIDC) was created and charged with the gradual elimination of Regulation Q interest rate ceilings on deposits; (5) Federal Reserve System services were to be competitively priced and made available to all depository institutions.

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The major objective of DIDMCA was to increase competition. Free market forces, it was argued, would lead to increased overall efficiency in the financial system. Another underlying objective was to provide a "level playing field" on which commercial banks, thrift institutions, credit unions and others could compete on equal footing. Clearly, however, the move from regulation toward freer competition has had differential impacts on the various providers and consumers of financial services. This article summarizes the findings of a study of the opinions of those directly affected by deregulation.[1/]

The Data

Mail-in questionnaires were sent to the chief executive officers (C.E.O.'s) of 116 insured commercial banks, and 84 insured savings and loan associations (S&L's) in March, 1981. The number of these institutions included in the sample represent their respective shares of total assets held by all banks and S&L's in Ohio. Useable questionnaires were returned by half of those surveyed.

The questionnaire consisted of 13 sections, of which 11 were statements with which the respondent could agree or disagree and 2 were in the form of a short answer or comment. The results are reported in the form of a numerical scale on which +2 = strongly agree, +1 = agree, 0 = undecided or neutral, -1= disagree, and -2= strongly disagree. One of the 11 statements was omitted from the analysis, due to apparent misinterpretation by the respondents. The results obtained from each of the remaining 10 statements are reported for the two separate sample categories--banks and S&L's. Responses were also analyzed

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1/ See Mace, Barbara J. "Deregulation of Depository Institutions," unpublished honors thesis, Department of Agricultural Economics and Rural Sociology, The Ohio State University, May 1981.

for differences between small, medium and large institutions based on asset size for banks and S&L's combined; however, these results were, for the most part, not statistically significant.

Summary statistics are shown for each of the 10 statements in Table 1. The mean or average response, which can be regarded as being the "center of gravity" of each group's distribution, may assume any value between +2 (strongly agree) and -2 (strongly disagree). The standard deviation may be viewed as a measure of unanimity among the respondents in each category. For instance, with respect to a particular issue or question, a relatively small standard deviation reflects a greater degree of consensus among its members compared to a sample group with a larger standard deviation. Differences in responses between the two sample groups were analyzed with the t-test for differences between means. The F-test for equality of variances was also applied. Results for statements 3, 4 5 and 7 where the standard deviations are significantly different should be interpreted with caution.

Results

Statement 1. Your institution fully supports the phase-out of Regulation Q.

The opinions of bank and S&L C.E.O.'s differed tremendously with respect to their support of the phase-out of Regulation Q. While the majority of the bank C.E.O.'s support the phase-out, the majority of S&L C E.O.'s did not. The comparatively high standard deviations indicate a general lack of consensus among the respondents.

The lack of support from the S&L respondents presumably reflects their concern about losing the one-quarter percentage point differential between rates paid by banks and S&L's on most small denomination deposits. Also, S&L assets consist largely of long term, fixed-rate mortgages and their profit margins are more seriously threatened by the predicted increase in the cost of funds resulting from the phase-out of Regulation Q.

<u>Statement 2</u>. <u>Due to the gradual elimination of Regulation Q, the cost of funds for financial institutions will become extremely rate sensitive.</u>

The majority of all respondents agreed that their cost of funds will become extremely rate sensitive with the gradual elimination of Regulation Q ceilings. The slightly higher mean S&L response would seem to indicate stronger agreement with this statement, and the mean responses from banks and S&L's were significantly different. The relatively low standard deviations indicate a higher degree of consensus on this issue.

<u>Statement 3</u>. <u>Due to deregulation, mergers and consolidations will greatly reduce the number of financial institutions.</u>

Although the majority of all respondents expect the number of financial institutions to be greatly reduced due to mergers and consolidations, a higher percentage of S&L respondents expect this reduction. The relatively low standard deviation of the S&L responses reflects a greater unanimity toward this issue.

It was widely believed that some financial institutions could not withstand the transition from regulated, to free-market competition. Because of the longer term structure of their assets, thrift institutions have experienced greater difficulty in adjusting to the increased cost of funds, and the S&L responses to this statement reflect this concern.

<u>Statement 4</u>. <u>As a result of deregulation, both the assets and liabilities of financial institutions will become shorter term in nature.</u>

A majority of the respondents expect both assets and liabilities to become shorter term in nature, and the difference in the mean responses of bank and S&L CEO's is not statistically significant. The S&L respondents were more uniform in their opinion than the bank respondents.

Regulation Q, and in many parts of the country, state usury laws, have in effect protected interest rate spreads. Deregulation has forced financial institutions to shorten the term structure of their assets and liabilities so that rates charged on loans can be more quickly adjusted to changes in the cost of funds.

Statement 5. Competition between commercial banks and other thrift institutions will be greatly increased as a result of deregulation.

There appears to be widespread agreement that competition between commercial banks and thrift institutions will be greatly increased as a result of deregulation. The slight difference between the mean responses from banks and S&L's is not statistically significant.

Their responses suggest that both bank and S&L CEO's feel that the DIDMC Act of 1980 will indeed "level the playing field". Elimination of the quarter-point rate differential on deposits will enhance the ability of commercial banks to attract funds. Expanded lending authority for S&L's will permit them to diversify into consumer installment loans and other areas traditionally reserved for commercial banks.

Statement 6. As a result of deregulation, we will view a substantial shift of funds from those institutions operating primarily with money market funds into commercial banks and other thrift institutions.

The majority of the respondents did not expect a substantial shift of funds from money market funds to banks and thrifts. The relatively high standard deviations, coupled with the large number of "neutral" responses, indicate a general lack of consensus on the probable effects of deregulation on competition for funds.

Commercial banks and thrift institutions have always experienced disintermediation whenever market rates rose above Reg. Q ceilings, and since 1978, the growth in money market fund assets has been phenomenal. The gradual phase-out of Reg. Q will eventually allow depository institutions to pay whatever rates they believe are necessary to attract and retain deposits. However, until the phase-out is complete in 1986, the unregulated money market funds will continue to enjoy an advantage. Perhaps the C.E.O.'s negative responses to Statement 6 reflect their opinion that DIDMC will have little immediate impact on their ability to compete with money market funds.

Statement 7. Your institution fully supports doing away with the interest rate differential between banks and other thrift institutions at the completion of the six-year phase-out of Regulation Q.

Not surprisingly, there were major differences between the responses of banks and S&L's, and their mean responses are located near opposite ends of the scale. The majority of bank respondents favor doing away with the interest rate differential while the majority of S&L respondents favor retaining it. Moreover, the bank respondents displayed a greater degree of consensus, while the S&L respondents were more varied in their responses. In other words, the percentage of S&L respondents who favor doing away with the differential is greater than the percentage of banks who do not favor doing away with the differential. Positive responses from C.E.O.'s of large S&L's account for a major portion of this variance.

Statement 8. Your institution is in favor of the reformed method of policy-making as represented by the newly formed Deregulation Committee.

The mean responses to this statement from banks and S&L's differed significantly. While the percentage of bank respondents in favor of the DIDC is very similar to the percentage not in favor, almost 50 percent of the bank officers were undecided or neutral. In contrast the majority of S&L respondents were not in favor of the Committee. The degree of consensus is very similar for both banks and S&L's.

Clearly, the DIDC did not receive a strong vote of confidence from the survey respondents. The five voting members on the Committee represent the interests of banks, thrift institutions, credit unions, regulatory agencies and the Treasury. However, comments on our survey forms indicate that some in the thrift industry believe that they are under-represented. The negative responses of the S&L CEO's to Statement 8 reflect their relatively greater degree of skepticism of the DIDC.

Statement 9. Deregulation will help to ease the inflationary pressures in our economy.

To the extent that deregulation leads to greater rewards for saving and higher borrowing costs, the incentive to spend will be reduced and inflationary pressures should be eased. However, the overwhelming majority of both bank and S&L CEO's do not expect deregulation to help ease inflationary pressures. The mean S&L response reflects stronger opposition to this statement, as compared to the mean bank response. This difference is further exaggerated due to the relatively large percentage of undecided or neutral bank respondents. The degrees of unanimity are quite similar for both sample categories.

Statement 10. Deregulation will significantly increase deposits by "small savers".

The overwhelming majority in each category of banks and S&L's did not expect deposits by "small savers" to be significantly increased. There is relatively less unanimity among bank respondents, as a larger percentage of bank respondents are in agreement or were undecided on this issue, as compared to the S&L respondents.

The responses to Statement 10 merely reaffirm those to Statement 9. In other words, the respondents apparently do not believe that the elimination of Regulation Q will stimulate savings. Again, the respondents may be reflecting the opinion that there will be no significant impact until Regulation Q is completely phased out.

NOW Accounts

As provided in the DIDMCA, all financial institutions were given the authority to offer NOW accounts to the public, effective January 1, 1981. The questionnaire included a section designed to measure the extent of NOW account offerings three months after the effective date.

Of the depository institutions surveyed, 88 percent were offering NOW accounts to their customers by March, 1981. Commercial banks accounted for a larger portion of this percentage than did the S&L's. NOW accounts were offered by 98 percent of the banks surveyed, compared to only 77 percent of the S&L's. The percentage of depository institutions offering NOW accounts increased with asset size. For example, 74 percent of the small, 92 percent of the medium, and all of the large institutions were offering NOW accounts three months after they were permitted to do so for the first time.

Although a smaller percentage of the savings and loan associations surveyed offered NOW accounts, the S&L's that did offer NOW accounts tended to have lower minimum balance requirements than banks. Of the S&L's offering NOW accounts, 79 percent had minimum balance requirements that varied between $100 and $749. In contrast, 84 percent of the banks that offered NOW accounts had minimum balance requirements of $1,000 and above.

<u>Reasons for Deregulation</u>

In the last section of the questionnaire, respondents were asked to list what, in their opinion, were the major reasons or factors contributing to deregulation. It should be stressed that not all respondents held uniform opinions regarding the causal factors underlying deregulation. Therefore, an attempt has been made to summarize the more prevalent and representative responses given.

A large number of respondents from both banks and savings and loan associations cited lobbying efforts by consumer interest groups as being a major factor contributing to the deregulation of depository institutions. Many respondents believe there were extremely strong political pressures on both Congress and the Administration by these consumer groups.

Many of the respondents stated that high inflation in our economy was another important reason for deregulation. However, as noted in Statement 9, most of these responses were not based on the belief that deregulation would help ease inflation. Rather, many of the respondents stated that high inflation contributed to deregulation indirectly by reducing the incentive for saving due to the decrease in purchasing power.

Also given as a major reason for deregulation was the need for depository institutions to function in a more competitive, "free market" atmosphere. However, there were many respondents who disagreed with this competitive reasoning. Many respondents in favor of allowing market forces on interest rates to move freely stated that increased competition would improve financial efficiency and would help to prevent disintermediation.

A large number of respondents from savings and loan associations strongly believe that lobbying efforts by large commercial banks and by the American Bankers' Association were a major factor contributing to deregulation. On the other hand, many respondents from commercial banks felt that the desire by many savings and loan associations to increase their financial powers was a major factor.

Summary

The phase-out of interest ceilings and the elimination of the rate differential is supported by the majority of the bankers surveyed while the majority of the S&L officers surveyed do not support either. The overwhelming majority of all survey respondents expect deregulation to cause various changes in the financial industry. They are as follows: the cost of funds will become extremely rate sensitive, both assets and liabilities will become shorter term in nature, competition between commercial banks and thrift institutions will be increased significantly, and the number of financial institutions will be greatly reduced due to mergers and consolidations.

The results of the questionnaire do not support one of the consumer benefits deregulation is supposedly intended to deliver. The overwhelming majority of those surveyed do not expect deposits by small savers to be significantly increased. However, the results do reflect an increase in the variety of services offered to consumers. For instance, NOW accounts were offered by a substantial majority of the depository institutions surveyed. Although a smaller percentage of the savings and loan associations surveyed offered NOW accounts, the S&L's that did offer NOW accounts tended to have lower minimum balance requirements than banks.

The newly formed Deregulation Committee did not receive a strong vote of confidence from those surveyed. While nearly half of the banks surveyed were undecided or neutral regarding this reformed method of policy making, the overwhelming majority of the S&L CEO's surveyed were not in favor of the new Committee.

Of the total group surveyed, a slight majority did not expect a substantial shift of funds from money market funds to commercial banks and thrift institutions. Also, most of the depository institutions surveyed disagreed that deregulation will help to ease inflationary pressures in our economy.

In Retrospect

A smoothly functioning, and efficient financial system depends heavily on public confidence and trust, thus, total deregulation is unlikely. DIDMCA was merely intended to eliminate some of the over regulation dating back to the 1930's when drastic intervention was needed to restore a "safe and sound" banking system.

As noted in a March, 1982 Federal Reserve Bank of Minneapolis Annual Report "... the promise of DIDMCA is yet to be fulfilled.... The Depository Institutions Deregulation Committee, charged by DIDMCA with the responsibility to phase-out Regulation Q ceilings on deposit interest rates by 1986, has, to an extent, been stymied. A phase-out schedule adopted in June [1981] was overturned in the courts the following month. An increase in the ceiling rate on passbook accounts adopted September [1981] was withdrawn following a flurry of protest."

The slow pace of the phase-out of Regulation Q is, to some extent, understandable. The beleagured thrift industry would no doubt experience even more failures if Regulation Q ceilings were abruptly lifted, and widespread failures in the financial sector would seriously undermine public confidence in the system. However, the fact remains that more than two years after DIDMCA, small denomination deposits continue to earn less than half the yields earned on risk-free instruments such as US Treasury bills. Thus, some of the skepticism expressed by our survey respondents in March, 1981 seems to have been justified. Several thrift institutions and banks have failed, and others have been salvaged only through consolidations and mergers, most of which were arranged by the deposit insurance agencies. Borrowers are indeed experiencing the painful adjustments to free market competition, but small savers are not enjoying the predicted rewards. Moreover, the playing field has been only partially levelled. The quarter-point differential remains, and many thrifts are more concerned with survival than with exercising their newly acquired lending powers. Money market funds, still exempt from Regulation Q ceilings and reserve requirements, continue to enjoy a competitive advantage in the quest for funds.

Table 1. -- Statistical Summary of Survey Results

Statement	Means		Standard Deviation	
	Banks	S&L's	Banks	S&L's
1	+0.44	-1.02*	1.40	1.23
2	+1.46	+1.73*	0.65	0.62
3	+0.88	+1.48*	1.01	0.63*
4	+1.16	+1.46	0.85	0.59*
5	+1.43	+1.48	0.58	0.79*
6	-0.25	-0.75*	1.02	1.04
7	+1.35	-1.14*	0.88	1.29*
8	+0.06	-1.30*	0.95	0.98
9	-0.71	-1.25*	0.82	0.89
10	-0.71	-1.02*	1.08	0.83

* Significant at the 5 percent level or better

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